Pay progression for low-paid workers

Research Paper 2: The role of corporate decision-making

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SMF Social Market Foundation

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EXECUTIVE SUMMARY

This research report seeks to understand whether and how policymakers can use the tools at their disposal to shape corporate-decision making. In particular, it focuses on how to encourage businesses to use their decision-making to promote wage progression and career progression among low paid workers.

The problem of progression out of low pay

Successive governments have done much to increase the wage floor over the last 20 years, and the Low Pay Commission is near to fulfilling its target of reaching 60% of median earnings. Despite these achievements, the UK still has a very significant low pay problem. About a fifth of employees earn less than two thirds of the median hourly wage, contributing to high levels of in-work poverty.

Not only are many on low pay, but many remain stuck on low pay for considerable periods of time. Only a sixth of low-paid workers in 2006 managed to consistently escape low pay by 2016.

Focus of this report

Our research concerns itself with two routes to higher living standards for workers – **wage progression** and **career progression.**

- By *wage progression*, we mean pay rises among workers in a given job position. We focus here, in particular, on wage rises beyond increases driven by changes to the basic minimum wage floor.
- By *career progression*, we mean pay rises achieved through a change in job position – whether that be a promotion within a company or by shifting to an employer offering better-paid job positions.

The factors that influence firm behaviour on pay and progression for low-paid workers

The research notes that company behaviour on wage progression and career progression, and workforce training (an enabler of progression), is driven by a wide range of factors. These include:

- **Concerns about employees changing jobs (e.g. after being poached),** which disincentivise investment in employees, such as through training.
- **Employee bargaining power.** Trade union membership, an enabler of employee bargaining power, is associated with better access to training and higher wages.
- **Pressure from investors.** Investor activism can influence corporate behaviour on a wide range of issues, from environmental matters, to whether a company takes a short-term or long-term view on investment in the workforce.
- **The power of internal human resources departments,** who might be able to influence the extent to which career progression opportunities are provided.

- **The future of the workforce in an age of automation.** The prospect of future automation of tasks currently carried out by workers might discourage investment in training. E.g. while companies figure out how the future demand for skills in their industry might differ from the jobs currently undertaken by their staff.

- **Reputational concerns –** Companies such as Amazon have increased wages for lower paid workers in response to bad media publicity about poor working conditions. Over 5,000 businesses in the UK voluntarily pay the real Living Wage, with reputational benefits cited as a key driver of this.

- **Pressure from consumers.** Consumers are also concerned about workers' pay, with nine in ten of British consumers agreeing that wages should reflect living costs. However, the evidence is inconclusive on how this concern manifests in the form of encouraging pay and career progression for workers on low-pay in particular.

- **Pressure from prospective workers.** PwC research from 2011 found that providing opportunities for career progression was the most commonly cited factor which makes an organisation an attractive employer, among 52% of millennials globally. The same survey also reported that the most influential factor leading millennials to accept their current position was the opportunity for personal development.

- **Legal considerations.** Section 172 (S172) of the Companies Act 2006 obliges corporate directors to act in the interest of the company's employees, among other stakeholders such as shareholders, suppliers, and local communities affected by company activities. However, there is limited evidence that S172 has a significant impact on company behaviour given that it is difficult to enforce.

Policy recommendations

With the above considerations in mind, the report explores a range of policy options for changing corporate behaviour on pay and progression in the workforce:

- **A new requirement in Section 172 (S172) of the Companies Act requiring Directors to ensure workers share in the proceeds of growth in a company.** Government could mandate that company Directors have an obligation to ensure and demonstrate that employees, at all levels of the company, are sharing in the proceeds of company growth. Combined with the strengthened S172 reporting requirements discussed above, this could encourage a more even spread of pay and career progression within businesses.

- **Heightened review.** The Government should look to clarify the validity of a 'Heightened Review' by the Courts which would assess a Board's decision-making process in determining whether directors have breached S172. Currently, Courts will not interfere in a board's decision-making, on the basis of the Wednesbury principle, unless the Board's decision is one that no reasonable director could make. The Government should assess how a Heightened Review could reflect stakeholder interests.

- **Awareness raising of current S172 law –** It would be beneficial to raise awareness of S172 among employee shareowners. Where employees own shares in the company, they would

be entitled to bring an action against directors. Therefore, the Government could assess how far employee ownership schemes which include participation of low-paid employees would enable directors to be held to account by employees who are also shareholders.

Tailoring pay expectations to each sector - It may be possible to develop guidance on progression expectations in a sector. Such guidance could outline career progression expectations in different sectors to encourage employers to adopt best practice, and to raise awareness with employees of what paths are possible. For example, it could set out employee profiles and outline the stages of their career. This would not replace or amend the minimum wage regulation itself, but it would raise awareness that the existing minimum wage is the lowest boundary for certain sectors. The guidance on career pathways would be available for employers to gain an insight into what they could be doing to encourage wage and career progression.

- **Transparency requirements on pay progression and training.** Requiring firms to publish data on wages, progression, training budget and HR practices may exert pressure on them to conform to the expectations of consumers, investors, employees and / or wider society. This policy is likely to be most effective at influencing the actions of firms who are concerned about their reputation, as they would want to avoid a negative public image which could affect demand for their products or services from consumers or influence how they are viewed by investors.

    - The Government should require firms to draft a narrative report that explains their decisions on wage-setting and provides a strategy for supporting pay and career progression, including key targets for the future. This could form part of S172 reporting requirements, given our proposal above that employee progression is explicitly expressed as an obligation of directors within the Companies Act.
    - The Government should publish and publicise rankings and league tables by sector, identifying the firms with the largest pay ratios and worst records of pay progression and training using a simple quantifiable metric.

- **Encouraging shareholder activism.** Third parties should consider how treatment of low paid workers could feature more prominently and extensively in environment, social and government (ESG) criteria, alongside adoption of the Living Wage. (Share Action have developed some thinking in this area, however more third parties should follow).

- **Accreditation schemes could be used to highlight employers providing training opportunities equally across their workforce, including to low-paid groups.** We would expect government and other stakeholders involved in the construction of a new accreditation standard to engage with the corporate and investor community. Combined with increased investor activism, accreditation/kitemarking of firms doing the “right thing” on career/pay progression could help influence corporate decision-making. We would expect the accreditation to form a key benchmark for ESG investment.

CHAPTER 1: INTRODUCTION

There is a growing consensus that work is not providing a reliable route to better living standards in modern Britain. Low productivity growth, rising housing costs and a freeze of in-work benefits have resulted in an environment where, in 2017, eight million people lived below the poverty line, despite living in a family where at least one person was at work.[1] Many low-paid workers are stuck on their low salary: between 2006 and 2016, just one in six (17%) of workers managed to transition out of low pay and remain on a higher salary.[2]

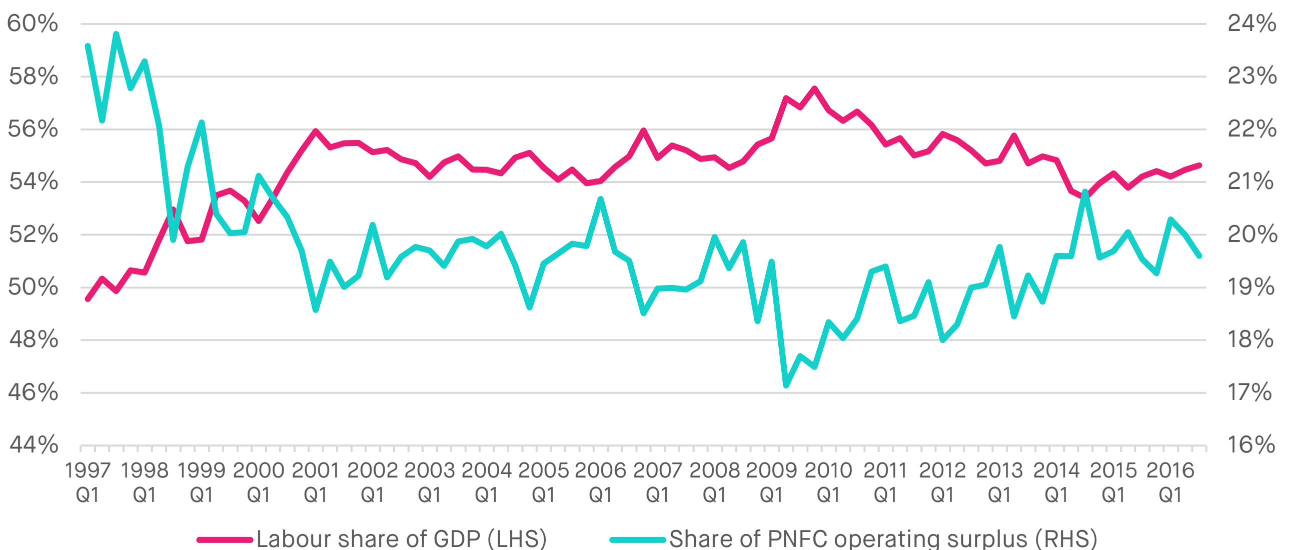
The debate around the experience of workers in the labour market should also be inclusive of the concept of 'meaningful pay' in terms of regularity of pay and predictability of working hours. Research from the Living Wage Foundation shows that one in six workers in the UK are in insecure low-paid work and face cancelled shifts or a lack of stable work hours, or are in short-term contracts.[3]

The focus of successive governments has remained largely on raising the wage floor, which has doubtlessly benefitted many workers at the bottom end of the income distribution. However, there has been a general lack of policy aimed at incentivising the progression of pay above the minimum (and national living) wage and the progression of a worker's chosen career, especially among the low-paid.

Public attention has been shifting towards the impact of business practices not just on consumers, but also on their employees, the surrounding communities in which operations take place, wider society, and the planet. The 2019 Edelman Trust Barometer finds that eight in ten (79%) of surveyed Britons expect CEOs to take the lead on change on a range of internal and external issues before government legislation incentivises action.[4]

Employees, especially those at the bottom end of the income distribution, can benefit from public debate focusing on the role of employers in providing not only a safe and humane working environment, but also opportunities for wage progression and career progression. ONS data show that, as a proportion of company profits, wages have declined, when compared to their level 20 years ago.

Figure 1: Labour share of GDP and of private non-financial corporation (PNFC) operating surplus



Source: ONS

A central question the ‘responsible capitalism’ agenda should take into focus is how workers can win a larger share of these profits through regular increases in wages and opportunities for career progression.

The recent initiatives by businesses to reduce the use of plastics (in the UK and globally) has shown that corporate behaviour can be altered in favour of benefitting the wider public by social pressure as well as by legislation. In the UK, following an extensive media campaign, 250 organisations including the Government signed a pledge to eliminate plastic waste and pollution by 2025.[5] Prior legislation – such as charges for the use of plastic carrier bags[6] and a consultation on banning the sale of plastic straws and cotton buds[7] – helped pave the way for this pledge, however the extent to which these regulations were a response to changes in public and/or media attitudes has not been evaluated.

In the first part of this research project, we explored how government can use tax and regulation policy in order to promote wage progression and career progression among low-paid workers.[8] In turn, this report seeks to evaluate the role of the corporate decision-making process in determining whether and when opportunities which result in a wage and/or career progression are offered by businesses.

As in our prior report on wage and career progression, we define the two routes into higher living standards as follows:

- By *wage progression*, we mean pay rises among workers in a given job position. We focus here, in particular, on wage rises beyond increases driven by changes to the basic minimum wage floor;
- By *career progression*, we mean pay rises achieved through a change in job position – whether that be a promotion within a company or by shifting to an employer offering better-paid job positions.

We note that many employers in the UK already offer wage progression, training, and other benefits to employees, including those on low incomes. We recognise that businesses in different industries and/or of different size can face a variety of external factors which influence their decisions on wage progression and career progression. The main purpose of this research is to explore why some firms behave differently on pay and progression from others when faced with the same external factors.

The rest of this report is structured as follows:

- *Chapter 2* discusses why business decision-making matters to pay and progression by providing an overview of the variation in wage levels and training opportunities for (low-paid) workers in the UK;
- *Chapter 3* outlines the factors which affect company decision-making on pay and progression for low-paid workers;
- *Chapter 4* identifies future policy developments which can improve wage progression and career progression among the low-paid.

Research methods

Our analysis included:

- An expert roundtable event which brought together senior officials from businesses and business groups and local and national policymakers to test out our preliminary findings and ideas. The discussion was held under Chatham House rules, but employer feedback was (anonymously) incorporated into our qualitative research;
- In-depth interviews with senior officials from business trade bodies in order to gain insight into corporate decision-making and its influences;
- Quantitative analysis of the Quarterly Labour Force Survey (July – September 2018)[9] and the Employer Skills Survey (2017).[10]

CHAPTER 2: VARIATION OF PAY AND TRAINING OF LOW-PAID WORKERS AND THE LINK TO CORPORATE DECISION-MAKING

Business behaviour on employee pay and opportunities for progression varies within sectors and within business types. In this chapter, we explore the extent to which firms which face similar economic conditions, accounting for industry and workforce size, behave differently with regard to pay and provision of training opportunities.

Variation in pay

In 2018, 17% of workers were low-paid;[11] this proportion varies across factors such as employer size, industry, occupation, and individual characteristics, as well as between firms of the same size in the same industry.

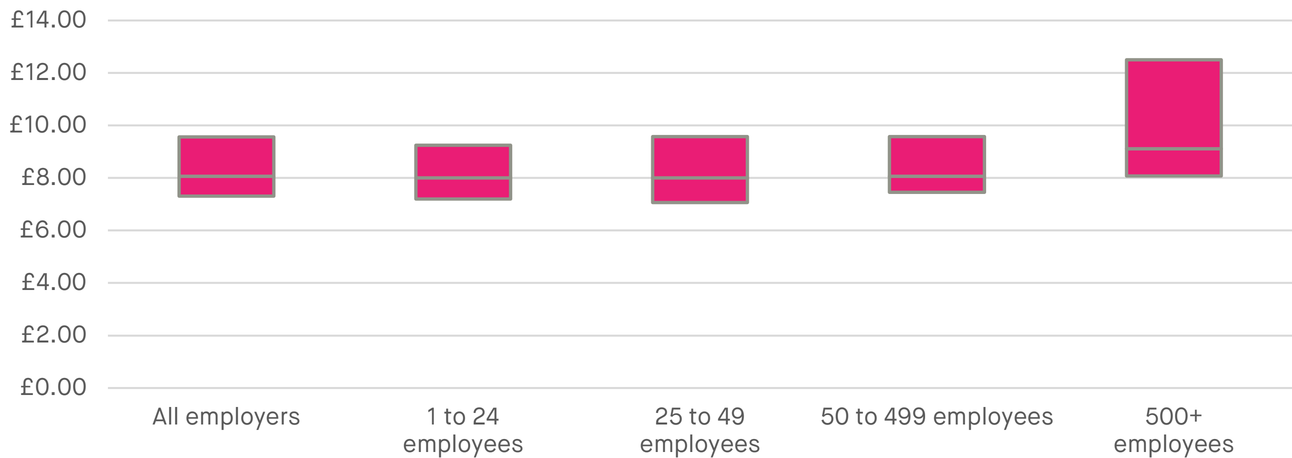
Below, we explore the distribution of hourly pay for workers in routine and semi-routine occupations (i.e. lower skill level) between firms of similar size in the same sector. To do this, we drew upon data in the Q3 2018 ONS Labour Force Survey. Due to sampling size issues, we focus on firms in the Wholesale and Retail sector (where 31% of staff are low-paid) and the Health and Social Care sector (where 15% of workers are low-paid).[12]

We cannot attribute the resulting variations in wages to corporate decision-making alone as other factors, such as regional effects and differing levels of productivity, also drive pay. However, employers do set the rate of pay for their jobs and do make the decision of whether or not to offer any training opportunities or whether to promote their workers to a higher paying position; these decisions can be influenced by a range of non-commercial factors (which we discuss in Chapter 3) and are ultimately reflected in wage levels.

Figure 2 illustrates our analysis for the Wholesale and Retail industry. On average, across firms of all sizes, workers in routine and semi-routine occupations in the sector received £8.07 per hour, with wages varying between £7.31 per hour (at the 25th percentile of the pay distribution) to £9.57 per hour (at the 75th percentile of the wage distribution). Breaking down these headline findings to account for firm size reveals little variation in the median hourly wage in all but the largest companies, where median pay increases to £9.11 per hour.

The largest employers are also more likely to offer the highest variation of wages between the median and the 75th percentile. This could suggest that the decision-making process on pay *might* be more variable in firms which hire 500 or more employees (this could also be reflective of varying company performance or larger firms hiring workers in a greater variety of roles). In comparison, the distribution of hourly wages appears to be most compact in employers which hire 50 to 499 employees.

Figure 2: Distribution of hourly pay among staff in routine and semi-routine occupations in the Wholesale and Retail sector, by employer size



Source: SMF analysis of Quarterly Labour Force Survey (Q3, 2018)
Note: The thick lines illustrate the distribution of hourly pay as follows: the middle line represents median pay, whereas the bottom and top lines outline the 25th percentile and the 75th percentile of the distribution, respectively

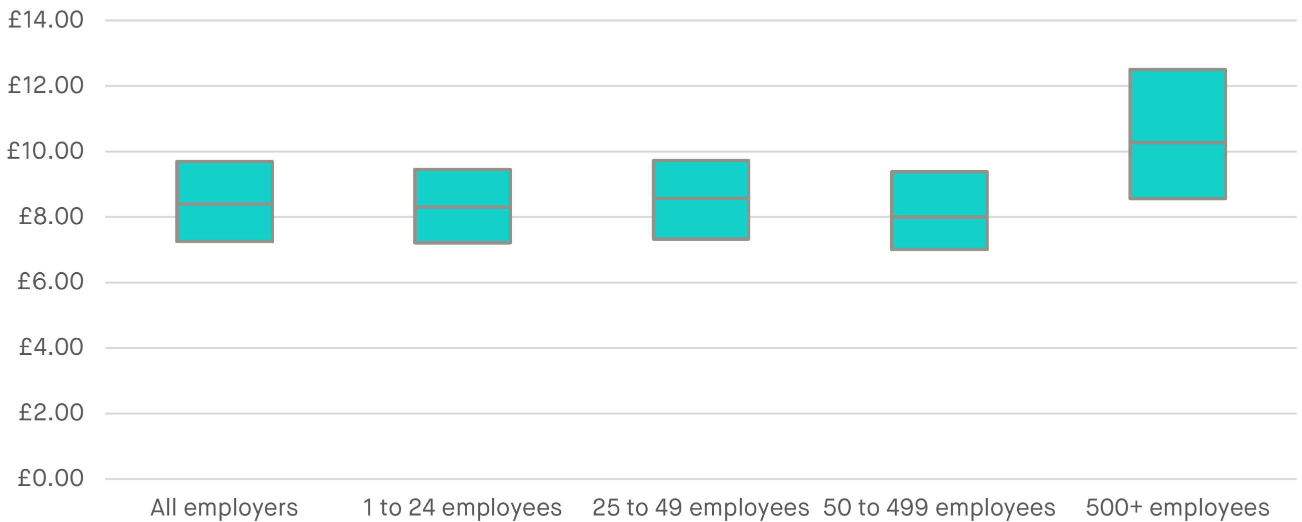
Whilst the median hourly wage earned by workers in routine and semi-routine occupations in the Wholesale and Retail sector is relatively stable across employers of varying sizes (excluding the largest employers), analysis of the mean hourly wage offers differing results: the mean hourly wage increases in lockstep with employer size. As a measure, means are affected by outliers or extreme values more than medians, which suggests that volatility of routine and semi-routine workers' wages in the Wholesale and Retail sector might be partially explained by the size of the company which has hired them.

Figure 3: Median and mean hourly pay among staff in routine and semi-routine occupations in the Wholesale and Retail sector, by employer size

Source: SMF analysis of Quarterly Labour Force Survey (Q3, 2018)

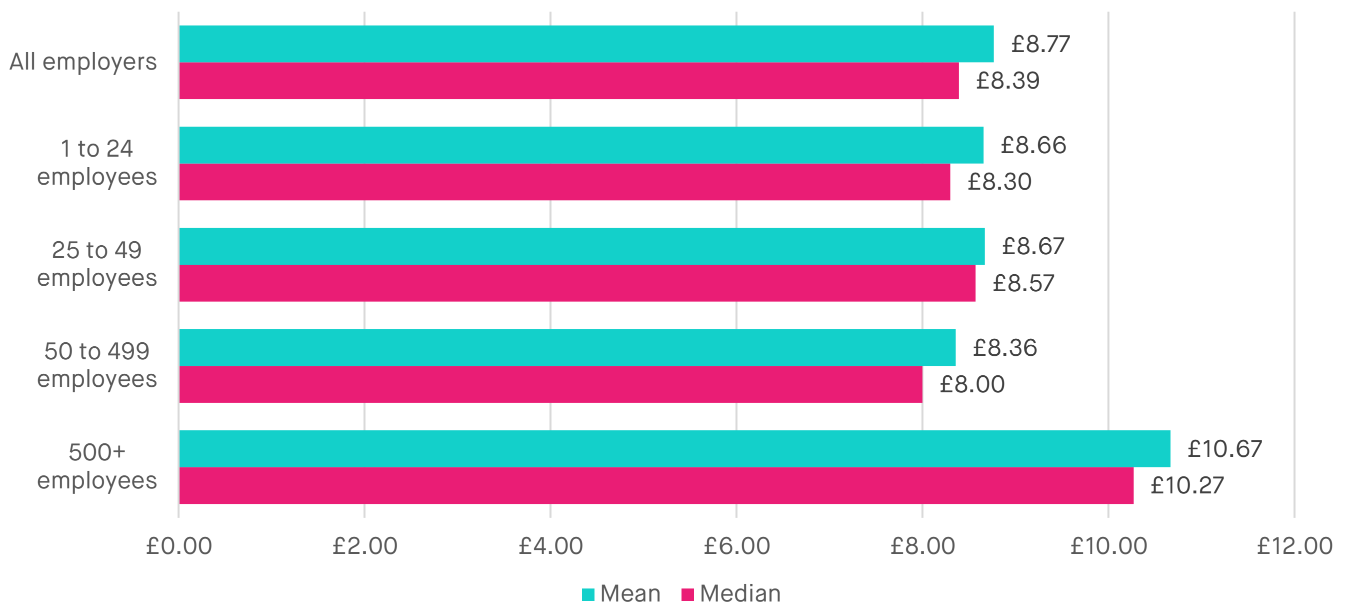
The Health and Social Care sector offers some differing trends, as illustrated in Figures 4 and 5. In comparison to the Wholesale and Retail sector, median pay is more varied across firm size: on average, workers in routine and semi-routine occupations in the sector receive £8.39 per hour, which rises to £8.57 among firms hiring 25 to 49 workers and to £10.27 in the companies with the biggest workforce (500+ employees). In this sector, the distribution in hourly wages was also wider across employer size. Mean hourly wages also do not seem to correlate to employer size. This suggests that the variation of hourly pay among workers in routine and semi-routine occupations is not universal across employer size in different sectors.

Figure 4: Distribution of hourly pay among staff in routine and semi-routine occupations in the Health and Social Care sector, by employer size



Source: SMF analysis of Quarterly Labour Force Survey (Q3, 2018)
Note: The thick lines illustrate the distribution of hourly pay as follows: the middle line represents median pay, whereas the bottom and top lines outline the 25th percentile and the 75th percentile of the distribution, respectively

Figure 5: Median and mean hourly pay among staff in routine and semi-routine occupations in the Health and Social Care sector, by employer size



Source: SMF analysis of Quarterly Labour Force Survey (Q3, 2018)

Variation in training

Training is one of the key routes towards wage progression and career progression. Theoretically, better-skilled workers are more productive and able to undertake more complex job tasks and, therefore, are worth more in the labour market. DWP research shows that having undertaken *any* training in 1998 – 2007 was associated with an increase in wages of about 0.5 per cent; however, employer-provided or employer-funded training increased pay by 2%.[13]

The following analysis of provision of training focuses on data collected by the Employer Skills Survey. In order to focus on the opportunities for training provided to low-paid workers in particular, we approximate pay with skill-level. However, due to data limitations, this renders us unable to differentiate the type of training which employees might be offered and undertake. Throughout our analysis below, 'training' incorporates initiatives which are unlikely to lead to pay or career progression (such as health and safety or first aid, basic and/or extensive induction) as well as initiatives which might be more likely to result in progression (such as job-specific training, training in new technology, management and/or supervisory training, and personal development training).

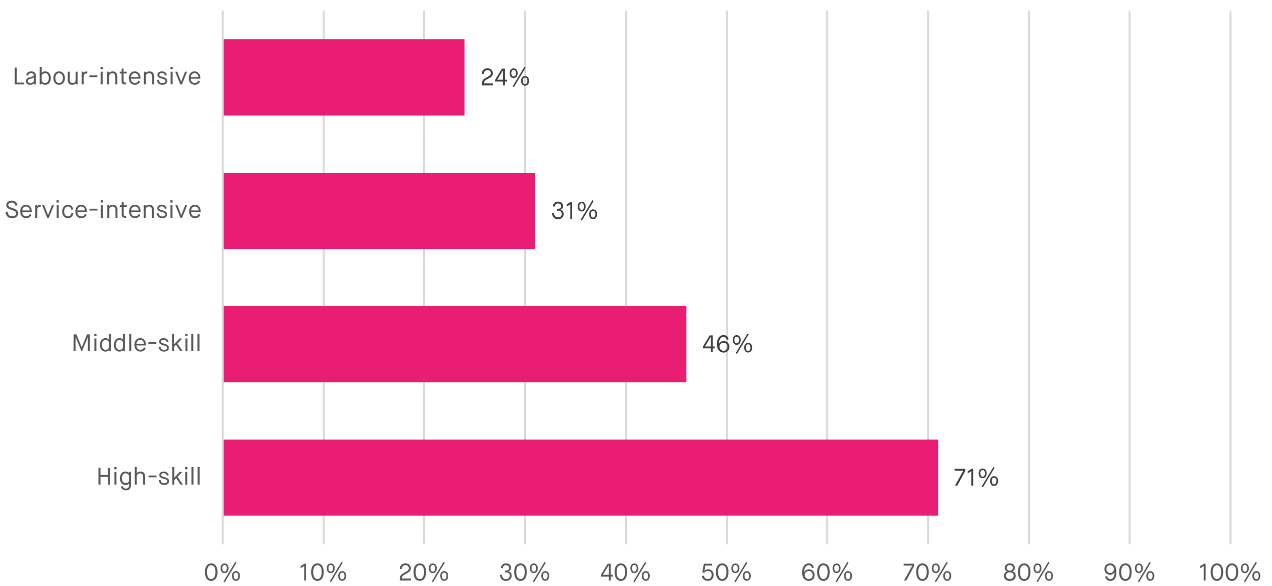
Provision of training varies markedly by industry and employer size. In 2017, 66% of businesses offered training to staff in the past 12 months (either on-the-job, off-the-job, or both), which benefitted 17.9m workers.[14]

Training incidence increased with employer size, from 42% among staff working for a small company with 2-4 employees to 68% in firms hiring 100 or more workers.[15] Training was also dependent on the industry sector, with employees in Health & Social Work and Education being the most likely to have received training in the last 12 months (79% and 76%, respectively).[16] One of the possible explanations for more training opportunities in these industries could be that most employer activity is based in the public sector, where industry regulators oversee training (as for example, the Care Quality Commission does).[17] In comparison, only half of employees in the Manufacturing and Construction sectors were trained in the same period (49% and 50%, respectively).[18]

However, both across industries and across firm size, lower-skilled employees, who are most likely to be low-paid, had lower exposure to training than workers at higher skill levels; training numbers tend to be driven by training undertaken by employees which worked in a high-skill occupation. Lack of training opportunities is probably one of the main factors holding back wage progression and career progression among lower paid workers.

As illustrated in Figure 6, high-skilled employees were the most likely to have undertaken training (given that they worked in firms which provided training in 2017), at 71%. In comparison, one in four (24%) of workers in labour-intensive jobs and three in ten (31%) of employees in service-intensive occupations received training in 2017. This raises important questions around the reasons why lower-skilled workers are less likely to receive training; especially given that such training could increase worker productivity and in turn company profitability.

Figure 6: Training in the past 12 months, by skill level



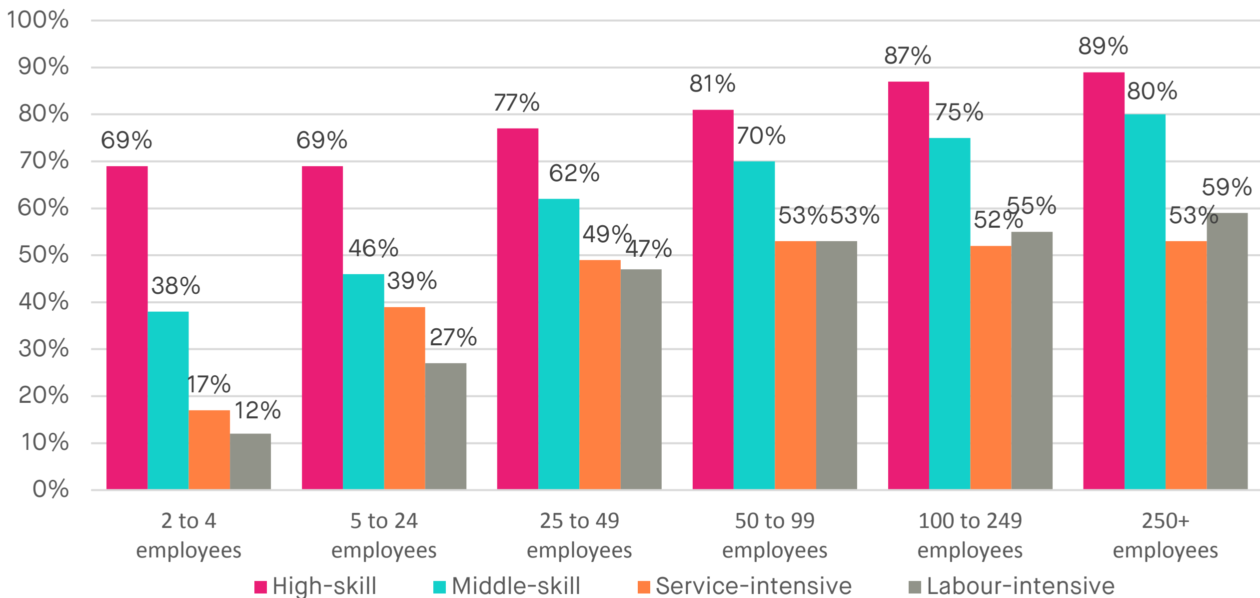
Source: SMF analysis of Employer Skills Survey 2017
Base: All firms providing training
Note on terminology:

- *High-skill includes managers, professionals, and associate professionals;*
- *Middle-skill accounts for administrative/clerical staff and skilled traders;*
- *Service-intensive is defined by caring, leisure, and other services staff and sales and customer services staff;*
- *Labour-intensive occupations are machine operatives and elementary staff*

This is also the case when we account for employer size. Although the likelihood of training being undertaken increases across all skill levels with the number of employees there are at a company, workers in high-skill and middle-skill occupations were markedly more likely to have received training than employees in service-intensive and labour-intensive occupations, regardless of employer size.

For example, training incidence for workers in labour-intensive and service intensive jobs increases from 27% and 39%, respectively, in employers which hire 5 to 24 employees to 59% and 53%, respectively, among the largest firms (which have 250 or more people on their staff), as shown on Figure 7. Seven in ten (69%) of high-skill workers in small firms received training; this proportion rises to nine in ten (89%) in the largest employers. This suggests that, although opportunities which could lead to wage progression and pay progression for lower-paid workers may rise as employer size increases, more of these opportunities are offered to higher paid employees regardless of the size of the workforce at each business.

Figure 7: Training incidence in the past 12 months, by skill level and employer size



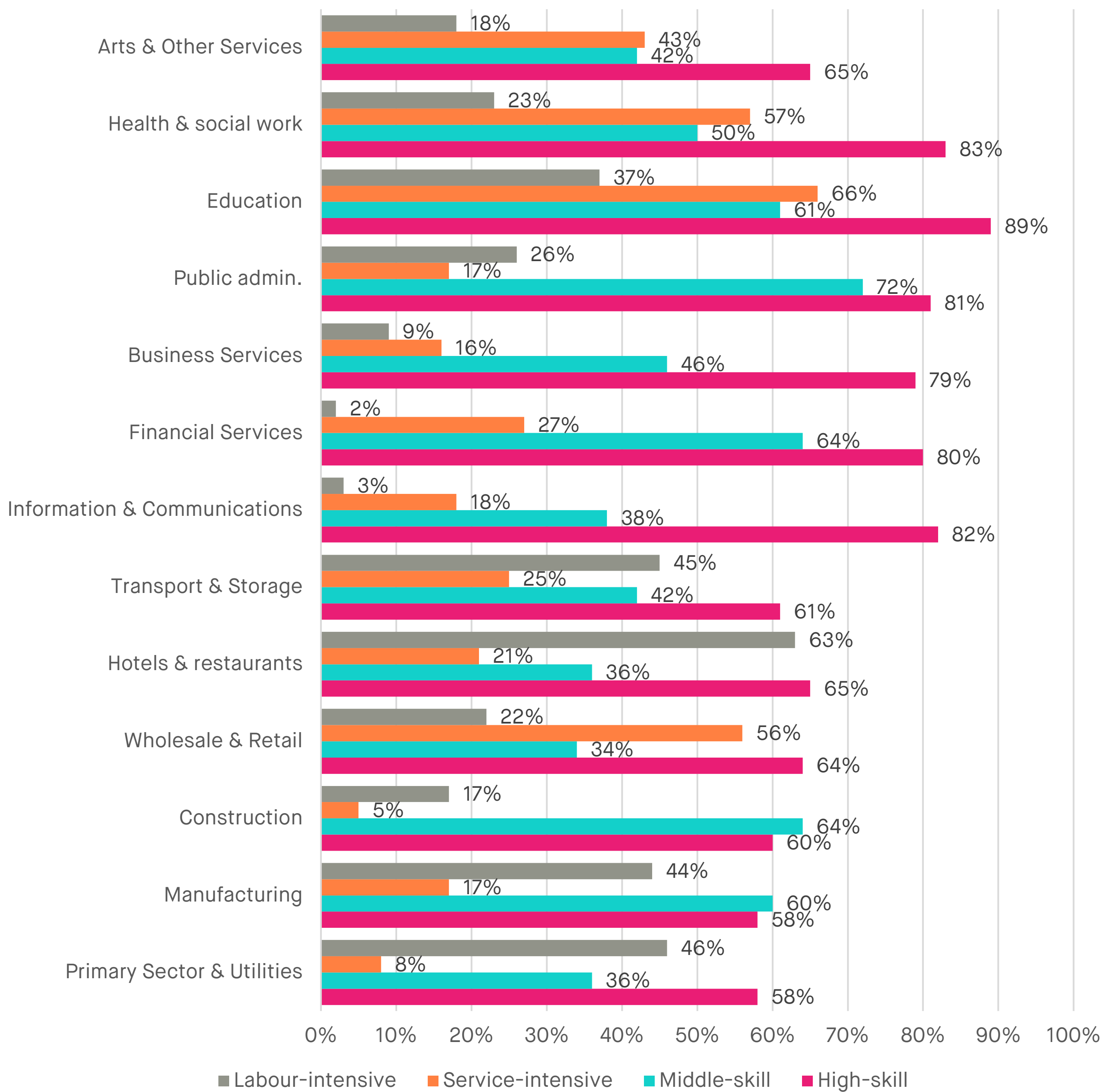
Source: SMF analysis of Employer Skills Survey 2017
Base: All firms providing training
Note on terminology:

- *High-skill includes managers, professionals, and associate professionals;*
- *Middle-skill accounts for administrative/clerical staff and skilled traders;*
- *Service-intensive is defined by caring, leisure, and other services staff and sales and customer services staff;*
- *Labour-intensive occupations are machine operatives and elementary staff*

Training incidence differs considerably across industries, as presented in Figure 8 overleaf. Again, high-skill staff were more likely to have undertaken training than labour-intensive or service-intensive workers, however the size of the gaps in training take-up between skill levels varies from sector to sector.

Staff in labour-intensive jobs in the Hotels and Restaurants sector, where almost six in ten (58%) of workers were low-paid in 2017,[19] were the most likely to have received training among other workers at their occupational level: six in ten (63%) undertook some form of training in 2016/17. In the Wholesale and Retail sector, where a third of workers were low-paid in 2017,[20] over half of employees in service-intensive occupations took up training in the preceding 12 months. These industries have the highest proportion of low-paid workers in their labour force, which suggests that training incidence might not necessarily lead to wage progression or career progression. For the entirety of the sector (i.e. not accounting for skill level of employees), the most common types of training offered in both the Hotels and Restaurants and the Wholesale and Retail sectors were health and safety and/or first aid training and job-specific training. Therefore, the type of training undertaken often may not result in pay and career progression.

Figure 8: Training in the past 12 months, by skill level and industry



Source: SMF analysis of Employer Skills Survey 2017
Base: All firms providing training
Note on terminology:

- *High-skill includes managers, professionals, and associate professionals;*
- *Middle-skill accounts for administrative/clerical staff and skilled traders;*
- *Service-intensive is defined by caring, leisure, and other services staff and sales and customer services staff;*
- *Labour-intensive occupations are machine operatives and elementary staff*

We note that an employer might wish to have an impact on workers which extends beyond pay and training opportunities. Wages are often part of a wider package of employee benefits (or benefits in kind), which can include break pay, flexible working arrangements, childcare vouchers, or staff discounts, to name a few. The scope of this research does not cover an in-depth analysis of such benefits; we are mindful of the fact low earners tend to attach greater value to those benefits. However, research shows that many employers have failed to maximise the value of benefits for low earners.[21]

CHAPTER 3: WHAT FACTORS INFLUENCE FIRM BEHAVIOUR ON PAY AND PROGRESSION FOR LOW-PAID WORKERS?

Corporate decision-making takes into consideration a wide range of influences. Some of these can be altered with great difficulty, such as the inherent values of the company. The culture and values of firms are likely to play a large role in whether already existing employees are provided with an opportunity to retrain or upskill rather than hiring new workers who are better skilled.

In this chapter, we focus on the range (and combination) of economic, socio-political, and legal factors which influence company decision-making when it comes to workers. In the next chapter, we discuss what pressures can be applied to these drivers in order to deliver better outcomes for the low-paid.

I: Economic factors

Business behaviour is largely driven by the economic conditions in which firms operate. Some of these conditions are universal across the commercial sector, whereas others have a varying degree of influence depending on firm size and the industry in which the business operates. Below, we focus on a select range of economic pressures which help to explain why some companies may behave differently when it comes to their employees, although they face similar economic conditions to their commercial competitors.

Pressures from the labour market

Human capital theory of poaching

Theoretically, one of the main barriers facing companies which wish to invest in human capital is the possibility of employees leaving the firm to work for other businesses once training has been completed.[22] As a result, firms are less willing to finance the general training of their staff (skills which are transferrable across employers), especially if they are located close to a large number of their competitors.[23] Academic research shows that, in the US, franchised employers in low-wage and high-turnover industries, such as fast food outlets, enforce no-poaching agreements within their franchise chain; however, this practice limits competition for jobs, which could also suppress wages.[24]

Training incentives arise when employees themselves invest more in their skills, for example by accepting lower wages today in expectation for higher wages in the future;[25] this practice however is weakly applicable to low-paid workers who earn at, or slightly above, the minimum (or national living) wage.

Tenure and workforce flexibility

Workers leave an employer for a variety of reasons which might not be related to training. Polling data from 2016 suggest that employees can perceive their job as a short-term role: around a third of new starters in the UK planned to leave their jobs within the first year and six in ten (58%) did not anticipate to work for the same company for more than three years.[26] Research from LV= estimates that young workers tend to change employer once every five years, on average.[27]

Importantly, the 2016 survey found that over half (53%) of UK managers expected the majority of new recruits to leave their company within three years, which can influence their decision on whether to offer an employee any training or progression opportunities.[28]

Reduced bargaining power of employees

Training opportunities and wage progression decisions might be tied to the extent to which a company's employees are unionised and the strength of their bargaining power.

Academic research supports the theory that training is more likely to be undertaken in unionised than non-unionised workplaces.[29] In the period 2001 – 2013, union members were 1.34 times more likely to have accessed job-related training in the previous three months than non-unionised workers.[30] The positive union effect on training is also associated with higher wages.[31] Additionally, if an individual worker is not a union member themselves, they still benefit from the union presence at their workforce, by also being likely to have received job-related training.[32]

However, trade union membership in the UK reached a peak in the mid- and late 1970s, when over half of the labour force was unionised.[33] In 2018, 23.4% of employees were members of a trade union, with membership being more common in the public sector (52.5%) than the private sector (13.2%), and among older employees.[34] In the past seven years, unionisation has decreased among all occupational categories.[35] Bank of England estimates suggest that the fall in the rate of employee unionisation has lowered pay growth by around 0.75 percentage points per year over the past 30 years.[36]

Additionally, the proportion of workers covered by collective bargaining arrangements has also decreased, from over six in ten workers in 1998 to four in ten workers today.[37]

Competition on pay and fringe benefits

Whilst in-work benefits can increase employee engagement and retention, they can also suppress wages. Theoretically, provision of fringe benefits is an additional constraint on total renumeration packages: offering benefits, which bears a cost to employers, reallocates funding away from pay. Benefits in kind can also incentivise employers to offer low rates of pay as the benefits themselves attract a wider supply of workers than workplaces which compete on wages alone.[38]

Evidence on company behaviour in low-pay sectors illustrates a mixed picture of how employers have adapted to the National Living Wage. A small proportion of employers report that they have reduced overtime pay and cut back on compensation for working unsocial hours in order to offset the cost of paying a higher wage floor.[39]

During our research, a large employer shared that they are not Real Living Wage accredited due to the variety of fringe benefits offered to their staff; additionally, when asked, their workers had expressed a preference for continuing to be eligible for in-work benefits rather than receiving an increase in basic pay.

Pressure from investors

The ownership structure of a company has an effect on corporate decision-making. In particular, listed limited companies have a number of external shareholders who are not involved in the

running of the business; this group can, however, assert an additional pressure on business behaviour without necessarily taking the company's (low-paid) employees under consideration.

In the UK, evidence suggests that shareholders tend to prioritise short-term gains over long-term plans such as investment in R&D and the skills of workers.[40] Business leaders, TUC representatives, and IoD members cited shareholder pressure as the most common driver of short-termism in 2012.[41]

Steps have been taken towards encouraging a more long-term approach, such as the scrap of required quarterly reporting following the Kay Review.[42] According to the Investment Association, 40% of FTSE100 and 60% of FTSE250 companies stopped issuing quarterly statements to their shareholders in 2017.[43]

Research by McKinsey Global Institute found that, among US companies, firms with more short-term focus not only invest less, including in human capital, but also perform less well over time than businesses with more long-term priorities.[44]

Academic research focusing on employers in England in 2009 showed that short-termism plays a role in explaining both the level of training activity supported by employers and its sensitivity to the economic cycle.[45] The paper found that training incidence and volume was higher among listed companies (with external shareholders) than unlisted companies (with internal shareholders), suggesting that short-termism might affect training activity as a result of a managerial opportunism rather than as a result of external shareholder pressure.[46] This implies that having external shareholders might not necessarily translate into a more short-termistic outlook.

A remaining challenge is to encourage businesses to consider the impact long-termism might have on the careers of their workforce in terms of improved retention and productivity.

Other economic factors

The following set of factors were brought to our attention as part of our qualitative research.

Structural organisation of industries

The structural organisation of companies in certain sectors acts as a barrier to wage progression and career progression. Labour-intensive industries, where many employees are likely to be low-paid, may offer little opportunity for training due to nature of work undertaken. The bottom-heavy structure of the sector requires a limited number of more senior and/or managerial staff, which hinders the opportunities for promotion due to the high competition for these roles.

Anecdotally, firms in the Hospitality sector would reap few benefits if they were to upskill a large share of their workforce, as additional training is not guaranteed to lead to career progression and large productivity/profit gains.

However, evidence from the retail sector in the US has shown that some large employers have deviated from the sector model of low training and low pay; as a result, these employers saw improvements in labour productivity, customer service, and innovation.[47]

The power of internal HR departments

Small and medium-sized firms might lack the resources to incorporate or fully utilise their Human Resources departments, which could in turn hinder opportunities for wage progression or career progression as the needs of employees might not be represented.[48]

However, firms of the same size and the same HR capabilities might provide different training opportunities, depending on the degree to which HR departments represent low-paid workers.

We expect that the proportion of low-paid workers in a business and their mode of employment to have a bearing on the power of HR departments. Anecdotally, we heard that internal HR departments in firms which directly hire a significant proportion of low-paid workers might be better suited to apply pressure for training and progression opportunities to be offered (where possible), in comparison to companies which hire a small proportion of low-paid workers or businesses which sub-contract them.

The future of the workforce

Some employers told us that they take into consideration not only the current skill needs within their organisation, but also are trying to adapt to the future expectations of what certain job descriptions will entail. As low-paid jobs at lower levels of the occupational ladder are at higher risk of automation, for example elementary occupations and sales and customer service occupations,[49] representatives of some firms told us that they might hold back on training their workers while they figure out how the future demand for skills in their industry might differ from the jobs currently undertaken by their staff.

Employer size

Due to the resources available to them, small- and medium-size employers may more likely to be focused on short-term survival rather than long-term initiatives such as investment in their workers. Previous JRF research has revealed that SME labour practices mirror those of their competitors, which can create a self-reinforcing culture of a lack opportunities for pay and career progression.[50]

International examples of changing firm behaviour: Retail in the USA

At the start of 2018, two of the biggest retail companies in the US pledged to increase the minimum wage paid to their staff. Walmart raised wages from $9 per hour to $11 per hour;[51] Target has committed to increase minimum wages to $15 per hour by 2020.[52]

Both companies cite having extra cash on hand due to recent corporate tax reform as the driver behind their wage hikes. In addition, low unemployment in the US has resulted in retail companies struggling to hire workers, especially around the holiday season in 2018.[53]

Amazon also announced an increase in minimum wages to $15 per hour (mirrored by an increase to £10.20 per hour in London and £9.50 per hour in the rest of the UK). However, this wage hike is likely to be offset by phasing out one of Amazon's share incentive schemes offered to employees. [54]

The decision by Amazon to raise wages came after competitors Walmart and Target had already announced an increase in their minimum wages. This shows that not all firms need to be, or

are, influenced to alter their behaviour via a blanket incentive such as tax reform: a sufficient number of firms changing their practices forces others in the industry to encourage competition on pay and progression throughout the market.

However, economic factors often do not influence corporate decision-making on their own; firms can also alter their behaviour to preserve or improve their reputation. When discussing the example above, we cannot avoid noting Amazon's history of attracting criticism over the disparity of pay between the company's minimum wage workers and the CEO. Although unmentioned officially, this aspect also had a bearing on Amazon's decision to increase base wages.[55]

II: Reputational factors

Case study: Becoming a real Living Wage employer

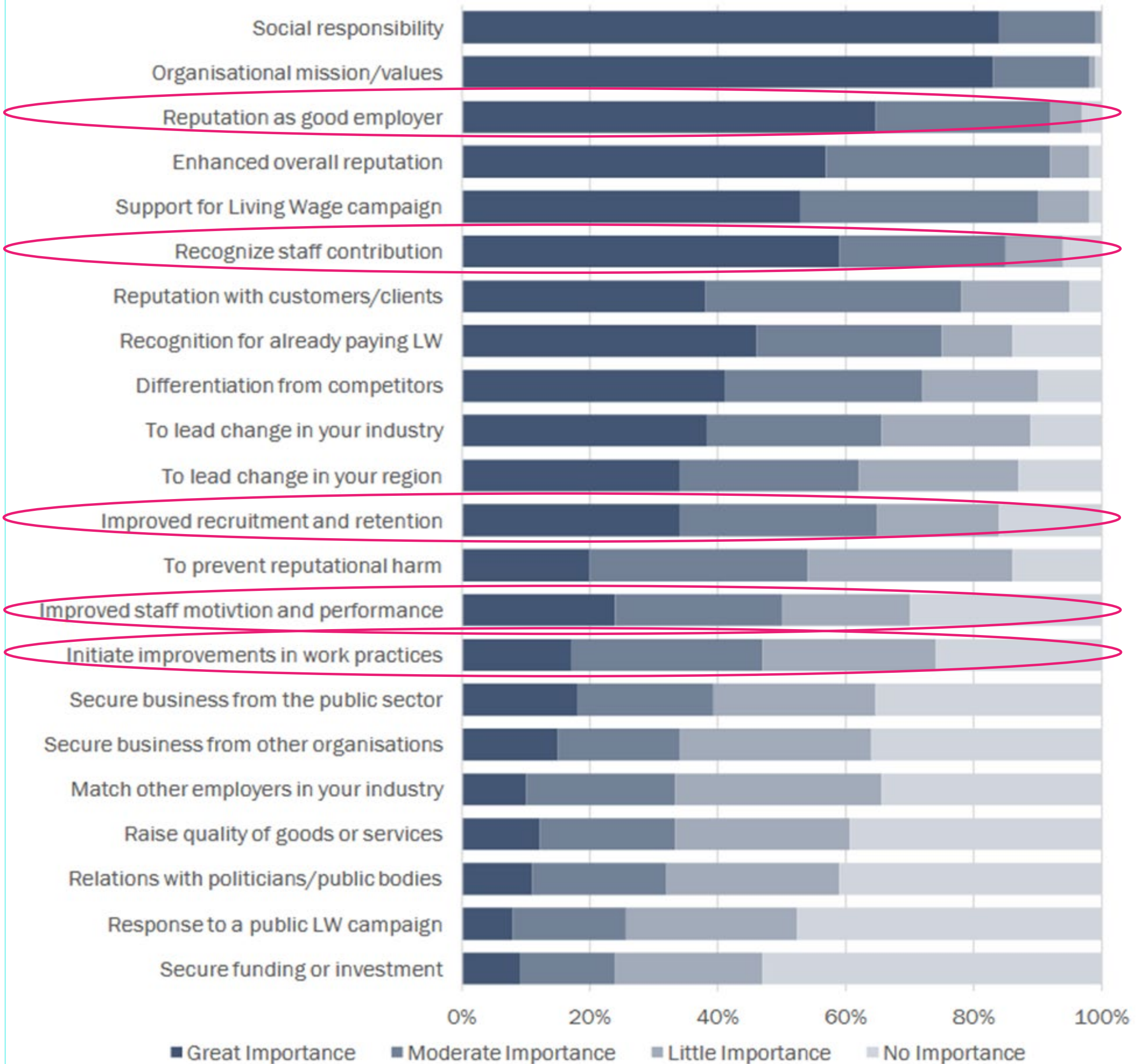
The real Living Wage is a voluntary wage floor, calculated by accounting for the cost of living rather than set as a percentage of median earnings.

Over 5,000 businesses in the UK voluntarily pay the real Living Wage.[56] Estimates suggest that around 200,000 workers have received a pay rise as a result of the real Living Wage campaign.[57]

Research by the Cardiff Business School exploring the employer experience of committing to pay the real Living Wage, highlights the mixture of factors at play behind corporate decision-making, many of which are related to improving or preserving the firm's reputation.[58]

As illustrated on Figure 9, out of the 22 most frequently cited factors driving the decision to become a real Living Wage employer, five consider employees. Two thirds of surveyed firms reported that developing a reputation as a good employer was a driver with great importance on their behaviour.[59] Recognising staff contribution was the most common influence which focused on employees directly (rather than on reputation).[60]

Figure 9: Why firms become accredited Living Wage employers



Source: Cardiff Business School

The study also evaluated the impacts on corporations which arose as a result of becoming a real Living Wage employer. The outcomes were largely positive, with 93% of firms reporting that they 'gained as a business' after accreditation; an additional 86% said that their reputation as an employer has been enhanced.[61] Internal interactions with employees also improved: 58% of surveyed companies saw better relations between staff and managers and 53% improved recruitment of employees into jobs covered by the real Living Wage.[62]

The increase in business wage bills after accreditation did not manifest into difficulty to win contracts among 87% of employers, or a rise in bills for subcontracted services among 68% of respondents.[63]

Stakeholder pressure can shape corporate decision-making in a way not too dissimilar from market forces. The rise of Corporate Social Responsibility initiatives in the UK (and globally)

shows that companies are taking into some consideration the impact of their business activities on a range of issues. For example, 504 UK companies have signed the UN Global Compact pledge to promote social responsibility in environmental protection, human rights, and labour standards.[64]

Publishing separate 'good practice' reports and advertising CSR efforts on corporate websites has become an increasingly prevalent feature in corporate policy[65] as such initiatives are seen as more business-friendly and a less costly alternative to top-down regulation by the government. In addition, strategic CSR initiatives can provide a firm with first-mover advantages, which can translate into sustainable competitive gains, as long as these initiatives are perceived as rare, valuable, and costly to imitate by competitors[66] and specific to the firm.[67] We expect reputational benefits to also follow a similar trajectory.

As company behaviour can be tracked, reported, and shared in an ever-increasing number of media outlets, we discuss three of the main groups which take into consideration a firm's reputation –consumers, investors, and the workforce – and the channels through which the changing attitudes of each group can influence corporate behaviour. We note that a wide range of other internal and external factors also influence companies' decision-making process when it comes to being more socially responsible, from NGO pressure to a concern to 'do the right thing'.[68]

Consumers

Consumers have become more engaged with corporate activities and more mindful of the indirect effects their consumption may have on a number of third-party groups: 90% of global consumers report that they would boycott a company if they learned of irresponsible or deceptive business practices.[69] Consumers now expect businesses to address social and environmental issues, with 91% of global consumers sharing this sentiment.[70] In response, corporations are incentivised to improve their practices in order not to dissuade consumers away from their products and services. Additionally, treating staff well could be incorporated into the image and brand of the goods and services offered by companies.

Consumer pressure has a history of influencing corporate behaviour, at least to a small extent. In the late 1990s, Nike suffered a fall in sales as revelations about the working conditions of staff overseas came to light.[71] In response, the company announced a series of steps to improve working conditions and the treatment of staff, such as increasing the minimum age of workers and implementing education programmes in factories.[72]

In the UK, ethical consumption has been on the rise – in 2017, households spent an average of £1,238 on ethical products.[73] According to polling undertaken by YouGov, 49% of adults in the UK made the decision not to shop at a particular outlet or purchase a particular product because of concerns over ethics; worries about labour standards were the fifth most cited reason for such personal boycotts.[74]

Consumers are also concerned about workers' pay, with nine in ten of British consumers agreeing that wages should reflect living costs.[75] However, the evidence is inconclusive on how this concern manifests in the form of encouraging pay and career progression for workers on low-pay in particular. For example, in the Textiles industry, 74% of British consumers report that they would be happy to pay an extra 5% for clothes if that guarantees that workers are being paid 'fairly' and are working in safe conditions,[76] but it is unclear what bearing opportunities for

progression have on perceived ‘fair’ pay or whether this statement would apply to employees in the UK in addition to workers throughout the supply chain. In the Food and Drinks industry, British consumers report being more concerned about animal welfare (74%) than placing importance on good worker welfare (57%).[77]

Investors

The global financial sector has seen a growth in ‘sustainable’ investment, in the forms of environmental, social, and governance (ESG) investing, ethical investing, impact investing, socially responsible investing (SRI), conscious investing, and green investing.[78] UBS reports that investors increasingly view sustainable companies as ‘responsible, well-managed, and forward-thinking’: in 2018, 82% of surveyed global investors believed that the returns of sustainable investments will match or surpass returns of traditional investments.[79]

Sustainable investment has also been on the rise in the UK. However, in 2018, a majority of British investors surveyed by UBS were confused about sustainable investment terms (79%).[80] As a result, only 20% of investors reported that sustainable investments make up at least 1% of their portfolios (compared to an average of 39% across the ten markets targeted in the study),[81] with millennials and women leading this trend.[82]

As sustainable investing in the UK has been projected to continue to increase,[83] we expect that listed companies will have an ever-increasing focus on how their business activities are perceived by investors and by the public. Research by Share Action highlights that institutional investors are paying more attention to the quality of labour practices in addition violations in core labour standards.[84] However, the debate focusing on the treatment of the workforce should also be inclusive of wage progression and career progression.

Prospective workers

Corporate reputation can determine the competition for jobs in an industry. As more workers expect their firm to be socially responsible, firms which are perceived as ‘good employers’ can attract a higher calibre of applicants for their vacancies than competitors whose reputation has suffered. In 2015, 42% of the workforce wanted their employer to make a positive impact on the world and 44% prioritised being engaged in ‘meaningful work’ which helped others over receiving a high salary.[85]

PwC research from 2011 found that providing opportunities for career progression was the most commonly cited factor which makes an organisation an attractive employer, among 52% of millennials globally.[86] The same survey also reported that the most influential factor leading millennials to accept their current position was the opportunity for personal development, followed closely by the reputation of the organisation.[87]

III: Legal factors

Whilst a full evaluation of corporate governance rules and standards in the UK is out of the scope of this research, this section considers the legal duties of companies and executives *towards* their employees.

Legal minimum wage

The Minimum Wage and the National Living Wage are the legally enforced pay rates for workers in the UK.

Whilst the vast majority of firms abide by these rates, underpayment has been on the rise in recent years, especially since the introduction of the National Living Wage in 2016. In April 2018, 23% of workers, or 369,000 people, entitled to receive the National Living Wage (i.e. individuals aged 25 and over) were paid below the wage floor.[88] An additional 70,000 younger workers were also paid at a lower rate than the one legally mandated for their age.[89]

For employers who do pay at the legal minimum rate, the future challenge is to encourage a cultural shift towards the view that the wage floor should be a firm's *minimum* commitment to its employees, with companies aspiring to pay staff more than this.

Section 54 of the Modern Slavery Act 2015

Section 54 of the Modern Slavery Act 2015 legislates for transparency in supply chains by obliging companies to ensure that modern slavery is not taking place in their business.

Businesses operating in the UK with annual turnover of £36m or more are required to produce a slavery and human trafficking statement every financial year, which sets out the steps taken to make sure that slavery and human trafficking is not part of any activities of the firm or the firm's supply chain, both domestically and internationally.

By encouraging the private sector to increase transparency on the actions of supply chains, S54 has contributed to raising awareness of slavery and human trafficking in supply chains and has encouraged many businesses to start considering the issue.[90] Employers and business leaders told us that the Modern Slavery Act has already made a big difference in ensuring that workers are treated more fairly across the supply chain.

However, the wider view is that the impact of S54 has been limited, with poor-quality statements being produced due to a lack of enforcement and penalties, and confusion surrounding reporting obligations.[91] Estimates suggest that only 60% of eligible firms have published any statement.[92]

Section 172 of the Companies Act 2006

Section 172 of the Companies Act 2006 is the strongest legal lever in corporate governance law; it obliges corporate directors (in private companies and publicly listed companies) to act in the interest of the company's employees, among other stakeholders such as shareholders, suppliers, and local communities affected by company activities.[93]

There is limited evidence on S172's impact on the actual behaviour of firms.

On the employer side, reporting requirements have been limited. Legislation in 2006 did not require boards to report their compliance *in sufficient detail* to their employees or shareholders. From 2019, large companies are required to include a statement in their Strategic Report on how directors have complied to S172.[94]

On the employee side, it is unlikely for workers or worker representatives to instigate claims of violations as they would have to demonstrate that the directors had not acted 'in good faith'. In

2017, the Government reported that no action has been taken by shareholders against corporate directors under S172.[95]

As part of our qualitative research, some employers shared that S172 has not had an impact on the industry in which they operate.

CHAPTER 4: POLICY PROPOSALS

This chapter outlines four main spheres where policy could be improved in order to influence corporate decision-making to deliver better outcomes in regard to pay and career progression for low-paid workers.

I: Strengthening company law

Although the evidence base is incomplete, current law appears to do little to influence business behaviour towards pay and progression at the lower end of the income scale. Below we discuss the extent to which this is taking place, the underlying reasons, and what actions could be taken in order to strengthen the influence of company law.

Shareholders' interests remain supreme

While Section 172 of the Companies Act 2006 obliges company directors to act with regard to the interests of employees, the extent to which this has any influence on decision-making around pay and career progression is highly questionable. In all likelihood shareholders' interests are likely to be supreme – particularly given the challenges employees and other stakeholders are likely to face in making a claim under S172.The likelihood of a claim under S172 is very low.

A derivative claim can be brought against a director with respect to a breach of duty under S172. But, the odds of a claim are extremely low. This is for multiple reasons. First, as discussed above and as Davies argues 'it is very difficult to show that the directors have breached this duty of good faith, except in egregious cases or cases where the directors have, obligingly, left a clear record of their thought processes leading up to the challenged decision.'[96] As of 2016, a decade after coming into law, no actions had been brought against directors under S172.[97]

Second, the large number of stakeholders to which directors must have regard makes it difficult for any single constituency of stakeholders to establish a convincing case.

Third, the duty under S172 is owed to the company; therefore, any claim against a director must be brought by shareholders on the company's behalf rather than by a stakeholder or stakeholder group. This implies that employees might not be entitled to bring forward a derivative proceeding.

Fourth, even if a shareholder were minded to bring a claim, derivative claims are subject to 'tight judicial control', likely to be costly and difficult to prove. For instance, the compliance test is very subjective as it requires the director to act in the way 'he regards' to be most likely to promote company success.[98] Courts are governed by the Wednesbury principle which holds that the Courts should not intervene unless the Board's decision is one that no reasonable director could make.[99]

'Soft' impact of S172

For these reasons, although Section 172 is part of 'hard' law, its impact is only ever likely to be 'soft'.[100] This is not to dismiss its potential to influence board decisions. The explicit inclusion of employees in S172 may encourage directors to reflect properly on their interests and how to maximise their contribution to the company's long-term success. Reporting and disclosure on S172 may further reinforce its impact as a normative measure.[101] There is a growing body of

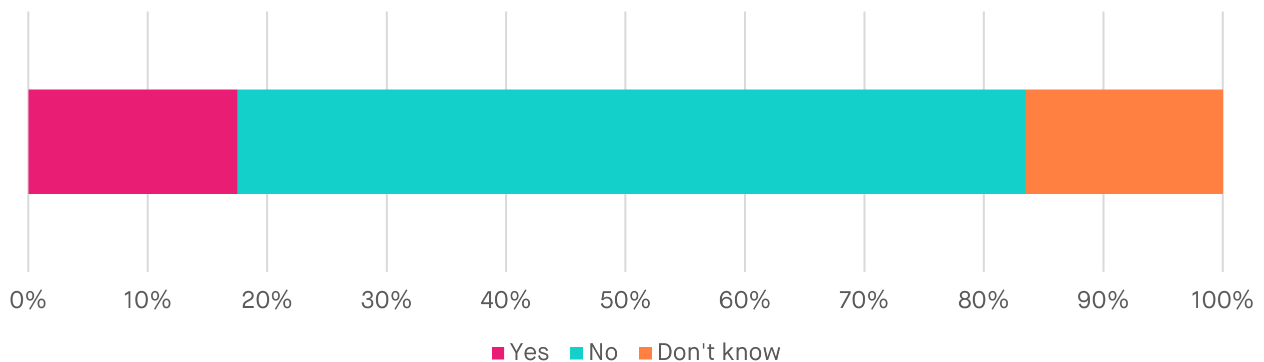
evidence that corporate decision-makers are influenced not only by hard law but also by norms and expectations. For instance, participants often trust and behave trustworthily to a far greater degree than is explained by legal or market incentives, driven in part by social context.[102]

Notwithstanding its potential, current evidence suggests that S172's soft impact is weak. One commentator has argued that 'the sort of directors who would have taken account of S172 would not need to be told to do so, and the sort of directors who ought to have been reminded of S172 would not have troubled themselves about it anyway, because, it is suggested, there was no compulsion to adhere to its terms and little likelihood of any punishment for their failure to do so'.[103]

Our own discussions with business through our research suggested that the legislation has had only limited impact on business behaviours in terms of determining pay policy. This bears out a 2012 evaluation of the 2006 Act for the Government which concluded that:[104]

- Awareness of the law's requirements among firms was high: 95% of large companies reported being aware of the duty to consider the impact of decisions on other stakeholders such as the community and the environment.[105]
- Stakeholders' views on the duties of directors revealed mixed perceptions on the effect of the law.
- Only a fifth of firms (17%) agreed that S172 had an impact on the way directors discharge their functions. The report concluded that, despite high levels of awareness, there had been 'no marked cultural shift in businesses' decision-making processes'.

Figure 10: Has the awareness of the duty to promote the success of the company affected the behaviour of directors?



Source: Department for Business, Innovation and Skills: Evaluation of the Companies Act 2006, Volume One (2012)

This underwhelming response may partly be explained by some firms feeling that they had the 'right culture' already in place before the legal change. Some have argued that the failure of the Government to publish guidance on how directors should comply with the Duty has contributed to its limited impact.

From 2019, large companies are required to include a statement in their Strategic Report on how directors have complied with S172. Additionally, firms with more than 250 UK employees are required to include a separate statement in their directors' report summarising how directors have engaged with employees and how they have 'had regard' to employee interests and the effects of that regard.[106]

This focus on process is welcome. Below we consider what additional steps, government could take to reinforce a norm of genuine consideration of employee interests.

Policy proposals

The Government is faced with a range of potential options:

Making employee wage progression part of S172

Government could mandate that company Directors have an obligation to ensure and demonstrate that employees, at all levels of the company, are sharing in the proceeds of company growth. For example, this could be done via either a profit-related pay scheme or employee share ownership. Combined with the strengthened S172 reporting requirements discussed above, this could encourage more a more even spread of pay and career progression within businesses.

Awareness raising of current law

Given the high levels of awareness among company managers reported in the 2012 evaluation, it is not clear that further awareness raising among this constituency will result in S172 having a significantly greater influence on business decision-making. However, we are not aware of any extensive evaluation of the impact of S172 since 2012, and propose that a survey be completed to inform whether further awareness raising programmes are needed.

Alongside this, we believe that it would be beneficial to raise awareness of S172 among employee shareowners. Where employees own shares in the company, they would be entitled to bring an action against directors. Therefore, the Government could assess how far employee ownership schemes which include participation of low-paid employees would enable directors to be held to account by employees who are also shareholders. This mechanism could also be utilised if awareness was raised among institutional shareholders and/or ethical shareholders.

Heightened Review

The Government should look to clarify the validity of a 'Heightened Review' by the Courts. Such a review would assess the Board's decision-making *process* in determining whether the directors have breached S172.

Currently, Courts will not interfere in a board's decision-making on the basis of the Wednesbury principle unless the Board's decision is one that no reasonable director could make. Ernest Lim has proposed that an analysis of the decision-making process is both supported by case law and by policy considerations.[107] The Government should assess how a Heightened Review could reflect stakeholder interests. As Lim argues, this approach may encourage Boards to interpret the steps or factors under the Heightened Review as 'best practices' and establish a legal norm.

II: Issuing official guidance on pay levels and progression

As suggested above, it may be possible to influence business decision-makers through 'soft' interventions that have a normative impact.

Minimum wage regulation has played a very important part in raising the wage floor and has eliminated very low (legal) wages in the UK. However, as described in our first report, it is difficult

to use regulation to promote wage progression and take-up of training. In contrast to hard regulation, voluntary guides do not impose mandatory requirements on firms nor increase enforcement complexity for regulators.

Below we describe how, beyond imposing regulations, the Low Pay Commission could take steps to encourage companies to adopt progressive pay policies. This could take the form of guides for specific sectors or expectations.

Tailoring pay expectations to each sector

As mentioned in our first report, evidence shows that different sectors can afford to pay different minimum wages.[108] A report by the Resolution Foundation explored how the LPC could offer a non-binding judgement on affordable wages by sector.[109] Informed by research, these judgements could encourage a shift away from the one-dimensional view of "low pay sectors", and instead differentiate where there is potential to raise higher wages. This policy would enable higher wage floors in some sectors, although it would not drive wages up progressively.

It may be possible to go further and to develop guidance on the progression expectations in a certain industry. Such guidance could outline career progression expectations in different sectors to encourage employers to adopt best practice, and to increase the awareness of employees in regard to the potential paths which should be available to them in their chosen profession and sector. For example, guidance could set out employee profiles and outline the stages of their career; after a certain amount of time at their current position, a guide could outline any types of training which could be undertaken by the employee in order to progress to the next level.

As industries differ structurally, these guides would need to be tailored in order to account for the needs of the workers in these industries. One methodology could be to adopt a manner not too dissimilar from the current criteria imposed on employers in a certain industry which wish to group together to form a 'trailblazer' in order to develop a new apprenticeship standard – such as the group being inclusive of a range of employers in various size and geographical spread.[110] We envision for the Government to hold a consultation on how to develop such guides, which would include engaging with worker representatives and representatives from businesses, professional bodies, and trade associations. In addition, the Low Pay Commission should be involved in order to represent workers towards the bottom end of the earnings distribution.

Alternatively, we could look at the details behind the utilisation of 'wage boards' from abroad, such as is the practice in Australia where a 'Modern Award' top-up is assigned to the minimum wage in accordance to specific industries and occupations.[111]

Such guides could encourage employers to provide more opportunities for employee progression, whether through training or other means. Employees would also be more informed about the potential for progression. The wage guidance could be accompanied with recommendations for training to support career progression. An additional component of this guidance could include strategies for increasing productivity, in order for low-paid workers in less productive industries to also reap a benefit.

This policy would not replace or amend the minimum wage regulation itself, but it would raise awareness that the existing minimum wage is the lowest boundary for certain sectors. The

guidance on career pathways would be available for employers to gain an insight into what they could be doing to encourage wage and career progression.

III: Using stakeholder pressure

Chapter 3 described how firm decision-makers may be influenced by multiple stakeholders, including consumers, investors, employees and the wider public. Below we describe what policymakers could do to increase pressure on decision-makers to give due consideration to wage progression and career progression among low earners.

Transparency requirements on pay progression and training

Requiring firms to publish data on wages and HR practices may exert pressure on them to conform to the expectations of consumers, investors, employees and/or wider society. This policy is likely to be most effective at influencing the actions of firms who are concerned about their reputation, as they would want to avoid a negative public image which could affect demand for their products or services from consumers or influence how they are viewed by investors.

However, it is important to note that, if enough firms adapt their pay policies, this may put pressure on other firms to adapt their pay policies in line with the wider market, and the market may thus adjust to higher wages overall. Encouraging transparency on wages and training may also enable workers to choose employers who are likely to offer them better progression opportunities and put competitive pressure on employers.

Existing reporting requirements on pay and employment

Reporting requirements have been adopted recently to address multiple policy goals.

- **Gender pay reporting**. Legislation for gender pay gap reporting was introduced in 2017, with the aim of tackling the disparity between the average pay of men and women. By improving transparency and accountability, individual firms are now subject to public scrutiny.[112] The government have recommended for firms to also provide narrative reporting alongside their wage data, to set out objectives and targets, which can be assessed against in future years.[113]

- **Ethnicity pay reporting**. The Government recently consulted on a mandatory approach to ethnicity pay reporting.[114]

- **Ratio of chief executive pay to the average worker**. New legislation requires UK-listed companies to publish the ratio of chief executive pay to the average worker, as well as each quartile of pay, from 2020.[115] This aims to make businesses more accountable to their employees, shareholders, as well as the public.

An evaluation of the potential impact of the gender reporting policy indicated that the policy is likely to influence the actions of businesses, as the majority (84%) of them believe that gender pay gap reporting could damage the reputation of firms.[116] Early analysis by the IPPR of the impact of gender reporting requirements suggests that the policy has had a positive effect. Their analysis indicated that the policy had promoted media interest in the issue and had raised the profile of gender pay at senior levels inside organisations, as well as prompted employers to consider how they address unequal pay.[117] However, there have been issues with the scope and

quality of the reporting requirements, as well as the accuracy of the reporting. In addition, any compulsory reporting should generate a simple quantifiable metric, which can be understood by the wider public.

Potential to use reporting requirements to promote higher pay and career progression

We heard through our research that, in combination with transparency on pay ratios, requiring employers to publicise other information on wages, training and progression could be an effective mechanism for applying pressure to businesses.

Additional policies could be introduced to promote greater transparency on the wages that businesses pay and the career-development opportunities for workers. Businesses could be required to publish data annually on:

- Proportion of employees earning the NMW.
- Proportion of employees earning below the real Living Wage.
- Distribution of employees by wage band (for example quintiles/deciles of the national pay distribution). For instance, we note that the focus only on the chief executive oversimplifies the problem. Pay levels for other executive directors are also often very high.
- Annual percentage pay increase for employees, by each wage band
- Proportion of employees promoted to a higher wage band, by each wage band.
- Proportion of low paid employees that rose up an occupational band.
- Proportion of employees receiving accredited training, as well as more general training, by each wage band.
- The size of the company's training budget.

Additional measures that could maximise the impact of this data include:

- The Government should require firms to draft a narrative report that explains their decisions on wage-setting and provides a strategy for supporting pay and career progression, including key targets for the future. This could encourage remuneration committees to justify their actions and ensure that consideration is given simultaneously to the pay of those at the top and those at the bottom.
- This could form part of S172 reporting requirements, given our proposal that employee progression is explicitly expressed as an obligation of directors within the Companies Act.
- The Government should publish and publicise rankings and league tables by sector identifying the firms with the largest pay ratios and worst records of pay progression and training.

Such policies are likely to be ineffective for small businesses where the regulatory burden may be considered too high and, if not, where sample sizes would be too small for robust conclusions to be drawn from any data that is published. We suggest that the Government should seek to use the same thresholds in terms of employer size for different dimensions of reporting requirements (e.g. gender and low pay). We accept that this policy will not have a direct impact on small employers. It *may* have an indirect impact by raising the market rate of wages.

Reporting requirements might also be ineffective in certain industries where consumer choice is limited (for example, in social care) or where corporate activity focuses on business-to-business

services. In the latter case, pressure might be applied from the final purchaser of these services. Companies are increasingly demonstrating that their 'good practice' extends not only to their business activity but also reaches across the supply chain; this pressure is likely to have arisen from a mix of influences, from compliance to the Modern Slavery Act 2015 to receiving a Fairtrade certification.[118] In industries such as social care, pressure from the labour market might surface in the longer run, as prospective workers might be dissuaded to pursue a career in a sector which has historically offered low rates of pay and few opportunities for progression.

Mobilising investors

As well as mobilising consumers and wider society, more could also be done to influence investor activism on wage-setting and training for the low paid.

Socially-responsible investment

There is an ongoing debate in the investment community about the extent to which social investing is compatible with fiduciary duty. Institutional investors have a fiduciary responsibility towards their clients to maximise returns. The law, however, is not straightforward. A 2014 ruling by the Law Commission concluded that the fiduciary duty does not require pension trustees to maximise short-term returns at the expense of long-term returns; trustees can take environmental, social and governance (ESG) criteria into account where they may have a material financial effect on the company; trustees can make investment decisions based on non-financial factors provided there is no risk of significant financial detriment to the fund.[119] What remains unclear is whether investors acting on behalf of clients can pursue social objectives where these may come at the expense of financial returns.

This dilemma need not necessarily prevent wage levels and training being part of investment criteria. Research has shown that firms with high levels of employee satisfaction generate superior long-term returns, but that investors typically undervalue these intangible assets. Therefore, it has been argued that 'Socially Responsible Investment' that screens on employee welfare may improve investment performance.[120]

Existing environment, social and government (ESG) initiatives focused on low pay

Most environment and social framework (ESF) criteria do not focus on employment conditions and pay. However, there are already some initiatives seeking to promote higher pay for workers. Share Action – a charity that seeks to encourage responsible, transparent and socially-responsible investment - encourages investors to put pressure on company boards to adopt the Living Wage standard, and it set up a Living Wage Investor Collaborative to this end.[121] Share Action describes four arguments why investors should encourage companies to adopt the Living Wage:

1. The Living Wage as a wider 'indicator' of a firm's commitment to human capital management.
2. Direct benefits to the firm from the Living Wage (e.g. lower absenteeism and higher retention).
3. Reputational benefits to the firm that may enhance consumer and staff loyalty.
4. Macro-economic benefits from higher consumer spending.[122]

Share Action's Workforce Disclosure Initiative (WDI) asks firms for information about employees and their suppliers. The WDI includes questions on wage levels, payment of the local minimum wage, adoption of the Living Wage and pay ratios (highest paid officer versus the median by country). In 2018, 21 of the world's largest 100 companies disclosed information to the WDI. The WDI also includes questions on training. Although 59% of participating firms provided data on employee training, it is not sufficiently detailed to enable investors to determine training levels of low paid workers.[123]

Recent research by Southampton University Business School suggests that 85% of institutional investors report that investment in employees is an important factor in their decision-making.[124] Investors report that there are significant benefits attached to firms becoming Living Wage accredited: 98% believe it improves employer credibility, 94% acknowledge societal benefits of higher wages, and 91% view it as a positive for staff morale and satisfaction. There were similar rates of awareness for the positive impacts on reputation, recruitment and retention. Three in five investors (62%) report that Living Wage Employer accreditation is an important factor to consider.

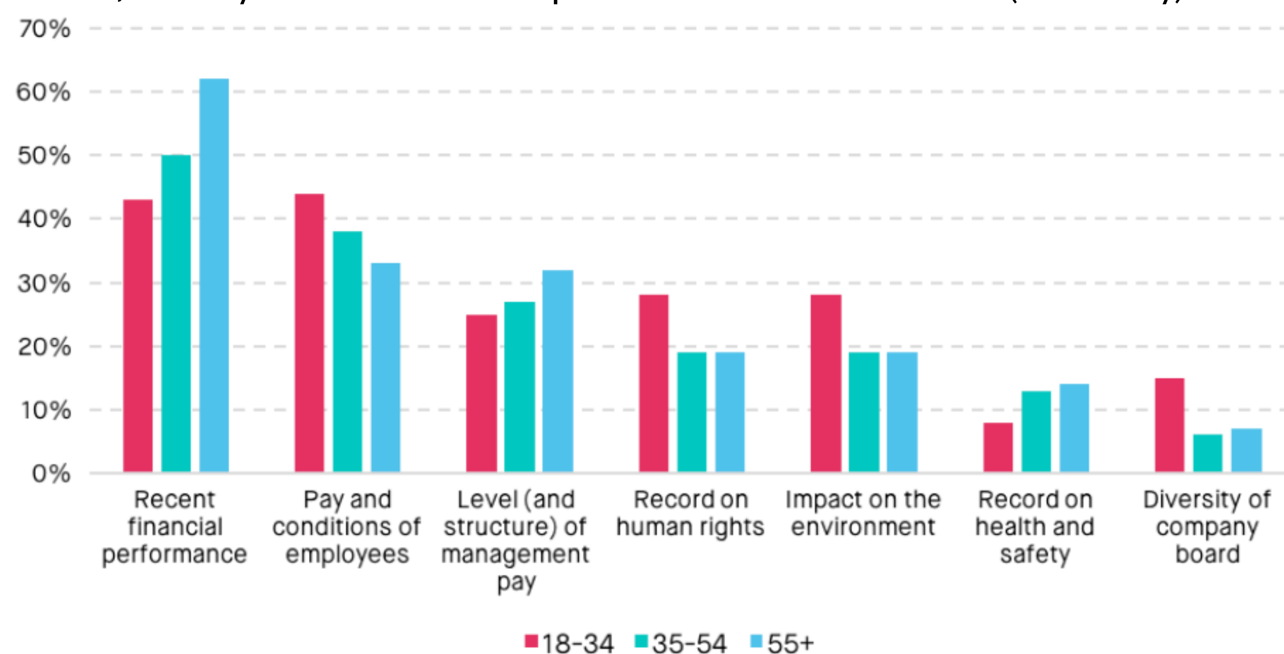
This evidence indicates that ESG criteria which focus on pay progression among the low paid as well as training could influence professional investors.

Mobilising retail investors

There are also significant opportunities to mobilise individual retail investors. By 2030, the Pensions Policy Institute has estimated that there will be around £500bn in defined contribution pension funds. Previous research by the SMF has identified latent demand among individual savers for ethical investments, with almost half of savers ready to sacrifice some returns in order to have their money invested in a social fund.[125]

Figure 11 reveals two important facts. First, 'pay and conditions of employees' is reported by investors of all ages as being the most important social or environmental issue for companies to take action on. This suggests that the issue of low pay and training could be salient with investors. Second, young investors are significantly more likely than older investors to prioritise social outcomes above purely financial returns. This suggests that this agenda could become increasingly important, although older investors who hold large stocks of pension capital are unlikely to drive change in this area. Indeed, ageing might shift attitudes towards funds which are more likely to deliver better returns, as the time period individuals have to make deposits towards their pension pots decreases.

Figure 11: If the primary fund of your pension provider were taking an active role in the companies they invest in, what do you think are the most important issues for them to consider? (NAPF survey)



Source: Social Market Foundation, Good Pensions: Introducing social pension funds to the UK

Even among NEST savers – who are likely to be the most disengaged as many of them have been auto-enrolled into their pensions – half (47%) say that it 'matters a lot' to them how 'their pension scheme considers how the companies and markets they invest in are run, and how they treat people and the planet'.[126] As Pensions Dashboards become widely available and enable individuals to be better informed about where their pensions are being invested, savers might drive a shift towards more 'responsible' pension funds.

Policy proposals

Previous SMF research has suggested that the market alone will not steer investments towards social causes even though many investors are motivated in favour of them. This is because many individual investors remain in default funds and because the supply of social funds may not respond to demand.

Multiple steps could be taken to promote the pressure that investors (institutional and individual) could have on board's decisions on training and pay.

- Third parties should consider how treatment of low paid workers could feature more prominently and extensively in ESG criteria, alongside adoption of the Living Wage. (Share Action have developed some thinking in this area, however more third parties should follow);
- Criteria could include availability and take-up of training among low paid employees: focus on training and development is less likely to conflict with trustees' fiduciary duty.

Addressing HR capacity shortfall in SMEs

As we noted in our first report, in recent years employee pay has increased more slowly in smaller firms than in larger firms. This is particularly problematic as some tools available to policymakers (such as reporting requirements) are less suitable for smaller employers.

In addition, small businesses inherently face very different challenges in relation to wage progression and career progression for lower paid staff. First, a smaller workforce limits options for job mobility within the firm. To gain promotion, workers in smaller companies may have to look for external opportunities. This in turn reduces the incentive for firms to invest in training for workers.

Second, SMEs may find it harder to grant staff time off for training because they have less flexibility around finding staff to fill in. Staffing levels may also constrain their ability to participate in apprenticeship schemes.

Third, small firms have less HR capability than large firms and therefore may find it harder to develop proactive and strategic HR policies including on human capital investment.[127] Many smaller firms lack dedicated in-house HR functions.

Fourth, the administrative costs of participating in government training schemes may be proportionally greater for smaller employers

Trade bodies and professional groups have sought to address this gap. For instance, the British Chambers of Commerce provides HR support and advice to members. The CIPD and Morgan Stanley piloted business support for SMEs.[128] These pilots found that that there is demand for HR support amongst SMEs, and bespoke, face-to-face provision could be an effective way of meeting the demand. It is unclear how SMEs would respond if they had access to better HR capacity.

Policy proposal

We recommend that the Government should explore an option for SMEs in the same sector to share HR capacities, for example through an organisation such as the CIPD.

IV: Accreditation schemes

Voluntary accreditation

There are now a significant number of voluntary accreditation schemes which employers can subscribe to if they fulfil specific criteria. Below we assess whether accreditation schemes could be adapted to include a focus on wage progression and career development. We note that a comprehensive review of the effect of voluntary accreditation schemes on behaviour has not been completed by third parties, and is out of the scope of this research.

Current examples of relevant accreditation schemes for employment practices

Accreditation schemes have been successful at promoting best practice among some employers. The most relevant scheme is the Living Wage badge, but others such as Investors in People and the badges being developed in Scotland and London offer useful templates and potential vehicles.

Table 1: Accreditation schemes: existing and in development

Accreditation scheme and purpose	Coverage and impact	Relevance to wage and career progression among low-paid workers
The Living Wage Foundation sets the **voluntary Living Wage**, based on what is required to earn to achieve an adequate standard of living.	Around 5% of the UK's workforce (1.5 million workers) are employed by over 5,000 organisations which commit to pay the Living Wage.	No requirement for pay increases and career progression.
The Living Wage Foundation has recently created a new standard – **the Living Hours programme.** This will require firms to pay the Living Wage and give workers a guaranteed minimum of 16 hours a week, advanced notice of hours and a contract that covers hours.	Too early to estimate	No requirement for pay increases and career progression.
Investors in People is an accreditation scheme that recognises employers who fulfil specific leadership, development and human resources requirements.	As of 2018, there were 2.7 million employees working for an Investors in People organisation.	Requirements for training opportunities though no explicit requirement about how these opportunities are extended to low paid workers or whether training opportunities are provided evenly across pay grades.
The London Mayor's Good Work standards set out four areas of practices that employers should adopt to be recognised with the Standard. These include paying the Living Wage.	Currently, 34 employers are listed as accredited on the Good Work Standard website, including several London Boroughs and the Big 4.	Requirement for employers to provide a structured training and development programme for all employees at all levels in the organisation, and to make clear progression pathways.
The Scottish Business Pledge covers nine domains, with a central requirement that all employers pay the Living Wage.	651 businesses have pledged.	This is part of a wider initiative by the Scottish Government through its 'Fair Work Action Plan', which asks employers to commit to investment in skills and training. 'Opportunity' is one of the five underlying principles of its framework, and 'allows people to access and progress in work and employment'.
The Greater Manchester Combined Authority has developed and approved a **'Good Employment Charter' for Greater Manchester.** This includes headline principles, and employers would be able to become supporters, members and advocates.[129]	Launched in 2019 with more than 60 businesses already signed up.	The conditions for being a member of the scheme include seven requirements including, 'Excellent recruitment practices & progression'.

Table 1 shows that there are already many accreditation schemes that focus on low pay and on training. However, none of these *explicitly* address challenges identified in our work: wage

progression and low-paid workers' access to training opportunities and career development. Many focus on promoting a blanket coverage to increase opportunities for all employees; this might lead to an over-representation of employers which do not traditionally hire a high proportion of low-paid workers (as they do not operate in low-paid sectors) or firms which sub-contract low-paid work.

There is a trend towards schemes with requirements which extend beyond the level of pay offered by the employer. The Living Wage Foundation's Living Hours programme suggests a willingness from the Foundation to promote other aspects of 'good work' beyond baseline pay. The new standards developed in London, Scotland and Manchester encompass broader attempts to improve multiple aspects of working terms, conditions and pay.

Policy measures

In assessing how best to include wage progression and career progression in any scheme, there is likely to be a trade-off between complexity of the accreditation scheme and impact. A very complex scheme which has numerous requirements is likely to be bureaucratic and expensive to administer; it may also dissuade participation due to high compliance costs or because employers may be unable to achieve all the desired requirements. A complex scheme is also likely to be harder to communicate and promote.

While we accept the dangers of excessive complexity, we believe that existing accreditation schemes and accrediting bodies could usefully do more to explicitly promote wage progression and career progression in their policies. We recommend for existing accreditations to consider including the following specific commitments in order to enhance pay *and* career progression for workers across all elements of the wage scale:

- Employers providing training opportunities equally across their workforce, including to low-paid groups.
- Employers committing to minimum levels of wage progression for employees in low pay.

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